UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Northern Border Pipeline Company Docket No. RP03-563-002

ORDER PROVIDING FOR ADDITIONAL COMMENTS ON OPTIONS

(Issued April 15, 2004)

1. On September 10, 2003, the Commission issued an order in this proceeding[1] rejecting Northern Border Pipeline Company's (Northern Border) filing to revise its tariff provisions governing the criteria under which Northern Border would have to accept a bid for less than the full length of haul of available capacity. Northern Border proposed that shippers submitting such short-haul bids at the just and reasonable tariff rate could not acquire the capacity for more than 31 days. In order to better resolve this filing, the Commission is requesting additional comment in 60 days on options for dealing with short-haul bids.

2. The Commission also recognizes the resolution of this case may have implications for other pipelines. The Commission therefore will permit late intervention in this proceeding to permit comments from all interested parties.

Background

3. Northern Border's pipeline system was built in the early 1980's as the Prebuild of the Eastern Leg of the Alaskan Natural Gas Transportation System and was constructed to accommodate long-term contracts for mainline capacity between specific receipt and delivery points. Northern Border uses a mileage-based rate design under which rates are based on 100 Dekatherm-miles.

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[1] Northern Border, 104 FERC ¶ 61,264 (2003).

4. Several of Northern Border's long-term contracts are expiring and the shippers may not be exercising their right-of-first-refusal (ROFR). As a result, Northern Border filed, on August 11, 2003, to revise the procedures for allocating capacity under its tariff.

5. Section 26.2 of Northern Border's GT&C addresses the posting of available firm capacity. Currently effective section 26.2(a) provides that Northern Border will post available capacity, the criteria for an acceptable bid, the method for determining the best bid as referenced in section 26.4(a), and the bid closing date on its web site. The bid period varies based on the length of the term of the bid. Northern Border states it includes a specific path in the posted criteria for an acceptable bid. Section 26.2(b) provides that if no acceptable bids are received during a bid period pursuant to section 26.2(a), Northern Border will post the capacity on its web site and award the capacity on a first-come, first-served basis at a mutually agreed upon rate under Rate Schedule T-1. Northern Border reserves the right not to award capacity to shippers bidding less than the maximum rate.

6. On August 11, 2003, Northern Border filed to revise section 26.2(b) of its tariff to clarify that the capacity posted under section 26.2(b) is subject to and remains posted pursuant to the criteria under section 26.2(a). Proposed section 26.2(b) provides that if a first-come, first-served bid at the maximum rate is received for a path within but shorter than the posted path, Northern Border will accept an operationally feasible maximum-rate bid received within 31 days prior to the effective date of a service agreement for a term not to exceed 31 days.

7. On September 10, 2003, the Commission issued an order rejecting the proposed tariff sheet. The Commission stated that its policy under Order No. 636 requires a pipeline to offer all of its existing capacity for sale to parties willing to pay the maximum rate, and that Commission policy must balance the right of a shipper willing to pay the maximum rates with the pipeline's right to obtain the highest net present value for its capacity. The Commission stated it would not permit Northern Border to force shippers willing to pay the maximum rate to pay the additional cost of taking a longer transportation path than desired, since this would shift the risk of unwanted capacity to shippers seeking shorter paths. However, the Commission clarified that, under its policy, a pipeline can have an extended bidding period and is not required to make a final award of capacity to a maximum rate bidder until 90 days before service on the capacity is to commence. The Commission, therefore, rejected Northern Border's proposed tariff sheet finding that Northern Border had not justified its proposal, because it deviates from Commission policy and prevents short-haul shippers bidding the maximum rate from ever acquiring capacity for longer than 31 days.

Request for Rehearing

8. Northern Border filed a request for rehearing of the September 10, 2003. Northern Border maintains that an exception should be made to the Commission's general policy requiring allocation of capacity to shippers bidding the maximum rate for short-haul bids on mileage-based pipelines. It argues that on a zone-based pipeline, any additional bids for capacity at different points will most likely be in the same zone and subject to the same maximum rate. In contrast, on a mileage-based pipeline, Northern Border contends that any shortening of the path reduces the maximum rate. Northern Border argues that the Commission's order will burden the pipeline and its other customers with unused capacity, because it would be unable to sell the entire path at a later point in time if demand for the long-haul capacity developed. It argues that requiring it to sell short-haul capacity would burden its existing customers because it could lead the pipeline to file a rate case in which the unsubscribed capacity costs would be reallocated to the other customers.

9. In particular, Northern Border argues that in today's gas market, forward markets and basis differentials play an important role in the ability to successfully re-subscribe pipeline capacity. It explains that if the difference in the base prices for gas at different points falls then demand for interconnecting capacity decreases, but if the price difference exceeds the maximum lawful price for interconnecting transportation the demand for transportation increases. Northern Border provides data, which it claims, demonstrates that price differentials have fluctuated significantly on a seasonal and inter-year basis and that the ability of the pipeline to wait for an additional period to sell capacity will result in a higher value for the capacity.

Discussion

10. This case raises important issues concerning the application of the Commission's policies on awards of capacity and the right of first refusal (ROFR) in a situation when an existing shipper chooses not to exercise its ROFR and, after the bidding period, the highest valued bid is a short-haul bid (bid for less than the full posted capacity path) at the maximum rate. Application of the Commission's current approach would require the awarding of that capacity to the short-haul shipper for whatever term it selects, leaving a portion of the capacity unsubscribed.

11. Section 284.7 (b)(1) of the Commission's regulations requires pipelines to "provide [firm] service without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification,

or undue discrimination or preference of any kind."[2] In implementing this regulation, the Commission's generally applicable policy for awarding capacity is that at the close of a bidding period, the pipeline must sell service to shippers willing to pay the maximum just and reasonable rate for the service they wish to purchase.[3] The shipper also would be able to dictate the length of its contract. This policy was adopted to ensure that the pipeline did not withhold capacity from the market. In the case of capacity subject to a ROFR, the bidding period can generally extend until the date on which the existing contract expires and new service can commence.[4]

12. The Commission's current policy seeks to effect a reasonable balance between the interests of the pipeline and the bidding shippers. It permits the pipeline to establish a reasonable bidding period for capacity to elicit the highest valued bid. However, at the close of the bidding period, it would require the pipeline to award capacity to the highest valued bid at the maximum just and reasonable rate applicable to the capacity. This provides a shipper bidding the maximum rate with both service and rate certainty for its planning purposes.

13. Application of the Commission's policy also is designed to provide an opportunity for the pipeline to obtain a value for the capacity that reasonably reflects the long-term value of capacity. The Commission recognizes that that the current gas market is characterized by short-term fluctuation in gas prices that can affect the short-term value

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[2] 18 C.F.R. § 284.7(b)(1) (2003).

[3] Tennessee Gas Pipeline Co., 91 FERC ¶ 61,053, at 61,190 (2000), Tennessee Gas Pipeline Co., 91 FERC ¶61,053 at 61,091, reh'g denied, 94 FERC ¶61,097 (2001), aff'd, Process Gas Consumers Group v. FERC, 292 F.3d 831 (D.C. Cir. 2002) (provisions protect against the exercise of pipeline market power by preventing capacity withholding).

[4] The Commission has provided that the pipeline should generally award capacity in such a situation in sufficient time so that the acquiring shipper has sufficient time to make appropriate gas supply or other arrangements. See Columbia Gas Transmission Corp., 94 FERC ¶ 61,301 at 62,107-108 (2001). In Columbia, the pipeline proposed, and the Commission accepted, a time frame of 60 days prior to capacity availability, at which the pipeline had to sell capacity under a contract for one year or more. For shorter term, contracts the pipeline could wait longer before allocating capacity to a maximum rate bid.

of transportation capacity.[5] However, shippers bidding on available long-term capacity should be taking into account the long-term value of capacity in submitting their bids. Bidders for long-term capacity should recognize that basis differentials change over time and that in bidding for long-term capacity, they need to consider the overall long-term value of the capacity, not just the current basis differentials. Any shipper that submits a short-haul bid risks losing the capacity to a longer-haul bidder that recognizes that the capacity has a higher expected long-term value. Thus, a short-haul shipper should not receive capacity when the market as a whole recognizes that the capacity is likely to have a higher future value.

14. Moreover, even if a short-haul shipper acquires the capacity, and demand for longer haul capacity develops later, the unused capacity is not necessarily stranded. Northern Border can use the already existing capacity as part of an expansion project to provide additional capacity to the newly developed long haul shipper. The use of the existing capacity will reduce the cost of such a project. Such an expansion would not only avoid stranded capacity, but would provide additional revenue to the pipeline and its investors.

15. Northern Border, however, maintains that this policy does not recognize that shippers' bidding will not very well reflect the long-term value of capacity, and that it will lose revenue as a result. For example, it maintains that capacity that was first posted for sale in December 2002 following a ROFR process was not re-subscribed until the basis differential exceeded the cost of subscribing to that capacity.[6] This could occur either because of an asymmetry in information (the pipeline has better access to information about the future value of capacity than shippers), or because shippers are more risk averse and are unwilling to risk a speculative commitment to capacity based on future value.[7] It also can be argued that the pipeline has little incentive to withhold

[5] Regulation of Short-Term Natural Gas Transportation Services, Order No. 637, 65 FR 10156, FERC Stats. & Regs. Regulations Preambles, ¶ 31,091, at 31,270-75 (2000).

[6] Northern Border rehearing, at 8.

[7] Shippers and pipelines also may have different costs for holding capacity until future prices change. For example, the cost to the pipeline of holding the capacity would only be the revenue forgone from not selling short-haul capacity for long durations, while the cost to other shippers might be paying the maximum rate for the long-haul capacity currently (less any amount they could recoup from short-term capacity releases).

capacity from a short-haul bid unless it reasonably perceives that a longer-haul bid will be forthcoming. A pipeline should not forgo certain revenue from a short-haul bid unless it perceives that a higher valued bid would be reasonably likely.

16. The Commission, therefore, is seeking comment on whether its current policy continues to appropriately balance the risks to the pipeline, bidding shippers, as well as the other shippers on the pipeline (which could be subject to paying higher rates if the pipeline files a rate case to re-allocate the costs of stranded capacity). Because this is an issue that may affect other pipelines and their shippers, the Commission will accept late interventions in order to submit comments on this issue.[8]

17. In evaluating this issue, it would appear that a short-haul bid for under one year would have relatively little impact on the pipeline's ability to market the capacity for a long-haul, because at the end of contract, the capacity would again be put up for bid. The more significant concern would appear to occur when a short-haul shipper requests a contract for one year or more. Under the Commission's current ROFR policy, even a one-year contract to a short-haul shipper could effectively strand the unsubscribed capacity, preventing the pipeline from re-marketing the capacity. The Commission's current ROFR would require the pipeline to allow the short-haul shipper with a one-year contract to retain its capacity by matching the highest rate bid for its current capacity path.[9] It would not have to match the rate on a longer-haul bid. As Northern Border points out, awarding the capacity to the short-haul shipper, therefore, might effectively strand capacity for a significant period, and could result in increasing other shippers' rates if the pipeline files a rate case.

18. In considering these issues, the Commission requests comment on the following options (or others proposed by commenters) for handling short-haul bids in the situation in which capacity becomes available because a current shipper opts not to renew its existing contract.

(1) Retain the current policy under which the pipeline must sell capacity to a short-haul shipper offering the maximum rate.

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[8] Although this issue may be most pronounced for pipelines with mileage-based rate designs, it can also affect a zoned-based system if for example, the expiring contract is for Zones 1 through 6, and the highest bid at maximum rate is for Zones 1 through 4.

[9] Order No. 636, FERC Stats. & Regs. Regulations Preambles ¶ 30,939, at 30,449 (1992).

(2) Provide the pipeline with discretion as to whether to sell short-haul capacity at the maximum rate. This would be similar to the Commission's policy not requiring pipelines to sell at discounted rates.

(3) Require the pipeline to sell the capacity to the short-haul shipper at the maximum rate, if the bid is the highest valued bid, but at reasonable intervals (one year, six months) the pipeline could repost the capacity, with the existing shipper being given a ROFR to match a long-haul bid (up to the original capacity path). In other words, at reasonable time intervals the capacity can be reposted to attract a higher valued full path bid. This approach would provide the short-haul shipper with service certainty, but expose it to more rate uncertainty.

(4) Require the pipeline to allocate the capacity to a short-haul shipper bidding the maximum rate, if the bid is the highest valued bid, but condition the short-haul shipper's exercise of its ROFR upon contract expiration on its having to match the highest bid for the full path of the original contract. Thus, if the shipper signs a one-year contract, it would have a ROFR but would have to match a bid for a longer path when it exercises its ROFR. This option would provide the shipper with rate certainty during its contract term, but could leave the pipeline with unsubscribed capacity for a longer period of time (if, for example, the short-haul shipper signs a five-year contract).

19. As part of the discussion of these options, the Commission requests comment on the following issues:

(1) Commenters should discuss, and provide evidence or examples regarding, the effect of basis differentials on shippers' bids for long-term capacity. This information should show whether shippers bid solely on the basis of short-term basis differentials or take into account the long-term value of capacity.

(2) Under options 3 and 4 above, commenters should address how to handle a rate case filing by the pipeline during the period when the capacity is unsubscribed. For example, comments should address whether a pipeline that has adopted one of the provisions and has re-allocated unsubscribed capacity costs in a rate case before a longer-haul bid is submitted should have such cost reallocation conditioned on the pipeline agreeing to credit to its shippers any revenues received in the event that a long-haul bid is received for the capacity.

(3) Commenters should address whether distinctions should be made between pipelines with mileage-based and zone rate designs.

The Commission orders:

(A) Comments as provided in this order must be submitted within 60 days of the date of this order.

(B) Parties submitting late interventions to submit comments will be granted party status.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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FEDERAL ENERGY REGULATORY COMMISSION

Northern Border Pipeline Co. Docket No. RP03-563-002

(Issued April 15, 2004)

BROWNELL, Commissioner, concurring:

1. The Commission's policy for awarding capacity is that at the close of a bidding period, the pipeline must sell the capacity to the shipper willing to pay the maximum rate for the service it wishes to purchase (i.e., shippers can bid on a geographic portion of the capacity offered for sale), if operationally feasible. Further, the shipper is also able to dictate the length of its contract. Northern Border proposes that shippers submitting short-haul bids at the maximum rate could not acquire the capacity for more than 31 days, a significant change to our current policy. Today we issue an order seeking comment on whether the current policy continues to appropriately balance the risks to the pipeline, bidding shippers, as well as the other shippers on the pipeline (which could be subject to paying higher rates if the pipeline files a rate case to re-allocate the costs of stranded capacity).

2. I appreciate the need to balance the risks of the cost of pipeline capacity among the various stakeholders but I also have some fundamental concerns and questions:

a. In Order No. 636, the Commission stated its goal "is to assure that all shippers have meaningful access to the pipeline transportation grid so that willing buyers and sellers can meet in a competitive, national market to transact the most efficient deals possible." Order No. 636, FERC Stats. & Regs. (CCH) ¶30,939 at 30,393 (1992). Can a regulatorily determined preference for long-haul transactions be consistent with the market-driven results for awarding capacity that has occurred under our current policy?

b. More fundamentally, section 284.7(b)(1) of our regulations specifically requires pipelines to offer capacity without "preference" as to duration of service or "preference of any kind". How is a regulatory preference for long-haul transactions compatible with our regulations? Is this an appropriate vehicle for amending the regulations?

c. The issue presented by Northern Border's proposal is not new. For example, Natural Gas Pipeline of America is a multi-zoned system. In 2002, the Commission did not allow the pipeline to prohibit a prospective shipper bidding on a portion of the term or capacity being offered for sale. 93 FERC ¶61,075 at 61,206 (2000). There does not appear to be any changed circumstances that would warrant us modifying a long-standing policy. What are the changed circumstances that would lay the foundation for a change in regulatory policy?

d. If the awarding of capacity to a short-haul shipper causes the pipeline to under recover its cost of service, the pipeline always has the option to file a rate case. Is not the rate case process the appropriate forum to address the issue of cost recovery and the allocation of cost responsibility?

3. I ask for your comments on these questions as well.

Nora Mead Brownell
Commissioner